

# focus

on

## Insolvency Law

June, 2008

The logo for Fraser Milner Casgrain LLP, consisting of the letters 'FMC' in white on a dark blue square background.

FRASER MILNER CASGRAIN LLP

### **BCE - THE QUEBEC COURT OF APPEAL STRIKES DOWN BCE PLAN OF ARRANGEMENT**

Recently, the Quebec Court of Appeal denied a motion for the approval of a plan of arrangement between BCE Inc. ("BCE") and 6796508 Canada Inc. worth \$51.7 billion. Although approved by the Quebec Superior Court, the Court of Appeal determined the plan to be unfairly prejudicial to debenture holders of Bell Canada, a wholly-owned subsidiary of BCE. The Court determined that the directors of BCE acted erroneously by limiting their consideration of the rights of the debenture holders to those named in the governing trust indentures.

BCE was incorporated in 1970, and now is Canada's largest communications company; Bell Canada ("Bell") became a wholly-owned subsidiary of BCE in 1983. In 1976, 1996, and 1997 Bell issued debentures under three separate trust indentures, each of a different series and date. Each series was rated investment grade and was marketable as debt. Bell made continuous representations to its debenture holders and the investment community regarding its commitment to maintaining investment grade ratings as a the core of Bell's financial strategy. The representations of Bell included:

It was "committed" to investment grade ratings; it was "totally focused" on investment grade ratings; that there was "no doubt about their ability" to maintain investment grade ratings; that investment grade ratings were part of Bell's "financial architecture"; that relationships with bondholders would be based on "fairness," not literal interpretation of contracts; and that stakeholder interests would be balanced.

In February 2007 BCE was approached to consider privatization. The board implemented a Strategic Oversight Committee ("SOC") to review any potential transactions and announced it was "reviewing its strategic alternatives with a view to further enhancing shareholder value". The debenture

holders expressed concerns of a leveraged buyout and sought comfort that the terms of the trust indentures governing the bonds would be honoured. The SOC assured the bondholders they would be.

BCE received an offer of \$42.25 per common share, which incorporated the intention to amalgamate Bell following the purchase. Such an amalgamation, according to BCE, introduced "unnecessary transaction risks", namely the protection mechanisms contained in the trust indentures which were triggerable upon amalgamation. BCE rejected the bid and accepted a revised offer that did not trigger these protections. Under the revised offer Bell would guarantee about \$30 billion in acquisition debt. The board unanimously recommended the deal and approval was given by greater than 97% of shareholders.

The debenture holders opposed the arrangement on the basis it was unfair, unreasonable, and oppressive. The Court of Appeal discussed both issues in the context of a directors' responsibility to stakeholders. The Court of Appeal was clear that creditors are stakeholders and are afforded the protections offered under the CBCA. The Court held that a director's responsibility is to make honest and good-faith decisions, and not to unfairly favour or prejudice any particular class of stakeholders for the benefit of any other.

The Court of Appeal noted that the oppression remedy of the CBCA grants the broadest rights to creditors Canada-wide, and possibly across all common-law jurisdictions. This remedy provides standing to a creditor to apply to a court for relief where a corporate decision unfairly prejudices or disregards their interests. This includes decisions made by a corporation, its directors, or its shareholders. As debenture holders hold securities in a corporation, they fall within the potential class of complainants as defined under the CBCA, and have standing to seek remedies for oppression.

The determination of unfair prejudice or discrimination against a class of stakeholders will turn on the reasonable expectations of the complainants. The determination of what these expectations are is factual and is based on the company's prior statements, history and nature, and relationship with the complainant. The court will also take into consideration the detriment to the complainant, the extent to which the oppressive acts were foreseeable and could have been protected against by the complainant, and the underlying expectations of the parties throughout. In other words, the legal rights as contractually provided in the trust indentures, while an important element of for the court's consideration, do not limit the reasonable expectations of the debenture holders. Instead, a court will consider all the prior words, deeds, and actions of the company and its directors when making this assessment.

The Court of Appeal opined that the approval procedure for a plan of arrangement under the CBCA is inter-related with the determination of oppression. If a plan is considered fair and reasonable, no action in oppression could be successful and will be rendered moot. Alternatively, if a plan is found to be oppressive it cannot be thereafter be approved as fair and reasonable. If a plan is found not to be oppressive this is not conclusive that the plan is therefore fair and reasonable, which must be determined separately on the merits. The Court of Appeal first considered if the plan was fair and reasonable before it would consider the issue of oppression.

The Court of Appeal found that the board of directors erred in focusing only on the contractual rights of the debenture holders pursuant to the terms of the trust indentures. The proper approach would have been for the directors to consider all the reasonable interests and expectations of all stakeholders. As the Court stated, "having regard to the finding of fact that the Plan adversely affected the interests of a class of securityholder (debentureholders), it was incumbent on the Board to look at their interests with a view to examining whether it was possible to alleviate or attenuate all or some of the adverse effects". Further, the Court of Appeal held that the board incorrectly considered its primary mandate was to maximize shareholder value. It incorrectly ignored the expected decline in market value of the debentures, and the diminished repayment potential for the debenture holders.

In summary, the process by which the board came to its approval of the plan was flawed and the Court of Appeal found that would therefore not give deference to the board under the business judgment rule. The Court went on to find that the board failed to give proper weight and balance to the interests of all the security holders in the corporation; the plan was unfairly prejudicial and therefore not reasonable. Without needing to address the issue of oppression, the appeal was allowed and the motion for approval of the plan of arrangement denied.

As initially noted, leave to appeal to the Supreme Court was granted and this decision was overturned. Reasons for the Supreme Court of Canada have yet to be issued.

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